Internal Revenue Service

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In Re:

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B02
PLR-113274-16

Date:
October 19, 2016

Dear:

TY:

Taxpayer =
Taxpayer Group =
W =
W Group =
X =
Y =
Bank =
Financial Advisor =
Z =
Accounting Firm =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =
Date6 =
Date7 =
Date8 =
Date9 =
Date10 =
a% =
b% =
c% =
d% =
$a =
$b =

$c =
$d =
$e =
$f
$g =
Year 1=
State =

Dear :

This is in response to a letter dated Date1, requesting an extension of time to make a safe-harbor election under Rev. Proc. 2011-29, 2011-1 C.B. 746, to allocate success-based fees between facilitative and non-facilitative amounts for Taxpayer's transaction during the taxable year ending Date2. This request is made in accordance with §§ 301.9100-1 and 301.9100-3 of the Procedure and Administration Regulations.

FACTS AND REPRESENTATIONS

Taxpayer represents the following:

Description of Taxpayer and W

Taxpayer was formed on Date3 under the laws of State. Taxpayer was formed in connection with the desired acquisition of W (the "W Acquisition"). Taxpayer is now the common parent of an affiliated group of corporations that join in filing consolidated U.S. federal income tax returns (the "Taxpayer Group"). Taxpayer uses the accrual overall method of accounting and a Date4 taxable year end.

W is a provider of early childhood care and educational services. W operates as a holding company of various operating subsidiaries that make up the group (the "W Group"). Prior to the W Acquisition, W, as the common parent of the W Group, filed consolidated U.S. federal income tax returns using the accrual overall method of accounting with a Date4 taxable year end. As a result of the W Acquisition, W's former consolidated group (i.e., W Group) terminated and a final short-period return was filed for the period ended Date5.

The W Acquisition

On Date5, Taxpayer, through its wholly-owned subsidiary X, acquired a% of the outstanding stock of W, an unrelated State corporation, for approximately $a of cash consideration, including cash raised through the issuance of new debt. The W Acquisition was structured as a reverse subsidiary merger, whereby Y, a wholly-owned subsidiary of X, was first formed on Date3. Y then merged with and into W, with W surviving. For U.S. federal income tax purposes, the formation of Y and its merger into

W was disregarded. Instead, the transaction was treated for federal tax purposes as a direct taxable purchase of stock of W by X. As a result of the W Acquisition, the W Group terminated and the members of the W Group became members of the Taxpayer Group beginning Date 6.

In order to fund a portion of the consideration for the W Acquisition, Y and W, as borrowers, entered into a credit agreement with a syndicate of lenders led by Bank. The debt consisted of term loans with an aggregate principal balance of $b million (the "Term Loans"). In addition, the lenders agreed to a revolving line of credit to be issued from time to time on or after the W Acquisition with an aggregate principal balance of $c. For purposes of the W Acquisition, however, $d million of the Term Loans was used to finance the acquisition.

Description of Financial Advisor Fees

In connection with the W Acquisition, Financial Advisor provided the following services to Taxpayer: (i) transaction advisory services related to the acquisition of W (the "Transaction Advisory Services"); and (ii) financial and structural advice with respect to debt financing of Taxpayer (the "Debt Related Services"). Collectively, these services are hereinafter referred to as the "Services."

Financial Advisor was compensated for the Services with a Total Fee of $e ("Total Fee"). This Total Fee represented b% of the total enterprise value of the W Acquisition and this Total Fee was contingent upon the successful completion of the W Acquisition.

Pursuant to a Management Consulting Agreement (the "Management Agreement") entered into with Z, a State corporation and wholly-owned operating subsidiary of W, Z agreed to pay, or cause to be paid, the Total Fee. Of the Total Fee, a portion of the fee (which later turned out to be c% or $f) pertained to the Transaction Advisory Services ("Transaction Advisory Services Fee"), and the remainder (which later turned out to be d% or $g pertained to the Debt Related Services ("Debt Related Services Fee").

The Missed Election

During the period in question, Taxpayer's accounting department and Taxpayer's tax department were both inundated with various matters related to the W Acquisition. In addition, Taxpayer's tax department consisted of only two individuals, neither of whom was engaged in the day-to-day operations of the Taxpayer's accounting department. As a result, the election at issue (the "Rev. Proc. 2011-29 Election") was missed.

On Date7, Financial Advisor provided a breakdown of the Total Fee via email to Taxpayer's accounting department (the "Financial Advisor Fee Email"). This email, in effect, allocated c% of the $e Total Fee to the Transaction Advisory Services Fee, and the remainder to the Debt Related Services Fee. However, due to various issues, the Financial Advisor Fee Email that was received by Taxpayer's accounting department was not contemporaneously shared with Taxpayer's tax department.

Nevertheless, this information was used by Taxpayer's accounting department in developing Taxpayer's financial statements for the period ending Date2. For example, Taxpayer's accounting department entered the $f Transaction Advisory Services Fee into one subsidiary ledger (the "Transaction Cost Ledger") and entered the $g Debt Related Services Fee into a separate subsidiary ledger (the "Debt-Related Services Fee Ledger").

In early Year1, Taxpayer engaged Accounting Firm to analyze the U.S. federal income tax treatment of the various transaction-related costs incurred in connection with the W Acquisition. The scope of Accounting Firm's analysis was limited to specific transaction-related costs and did not include debt issuance costs. On or about Date8, the Taxpayer's accounting department provided to Accounting Firm the Transaction Cost Ledger, but not the Debt-Related Services Fee Ledger.

Included in the Transaction Cost Ledger was a certain line item. This line item, in effect, provided the following ambiguous information with respect to the fee: Term Loans $b – Financial Advisor b% Total Fee--$g.

The individuals within the Taxpayer's accounting department who were overseeing the services performed by Accounting Firm had not been made privy to the Financial Advisor Email and had no knowledge of the Transaction Advisory Services Fee. Because the line item referenced the "Term Loans" with Bank, the individuals overseeing the transaction cost analysis being carried out by Accounting Firm believed that the $g fee that was mentioned in the notation related exclusively to debt issuance costs for the Term Loans (and therefore constituted a Debt-Related Services Fee). Accounting Firm was therefore advised that such fee was outside Accounting Firm's scope of review because, as previously noted, Accounting Firm was not engaged to analyze debt issuance costs. Accordingly, the Transaction Advisory Services Fee was never analyzed by Accounting Firm as part of its engagement.

When preparing the return on which the Rev. Proc. 2011-29 election at issue was required (the "Year 1 Return"), the Taxpayer's tax department looked solely to Accounting Firm's transaction cost analysis for purposes of identifying deductible transaction costs and incorrectly assumed that all costs not included therein were ineligible Debt-Related Services Fees (or were unrelated to the W Acquisition). The reliance by Taxpayer's tax department on the transaction cost analysis prepared by

Accounting Firm was due in part to the fact that the tax department had not been involved with the transaction cost analysis and had not been provided with any other information with respect to the Transaction Advisory Services Fee at that time. Accordingly, none of the $f Transaction Advisory Services Fee was treated as eligible for the relief provided by Rev. Proc. 2011-29. This resulted in the erroneous tax accounting treatment of the Transaction Advisory Services Fee. Likewise, no election statement ("Election Statement") was filed pursuant to Rev. Proc. 2011-29 with the Year 1 Return.

Accounting Firm reviewed the Year 1 Return prepared by Taxpayer's tax department, but, because Accounting Firm performed the transaction cost analysis with respect to the W Acquisition and was not aware of the Transaction Advisory Services Fee for reasons discussed above, Accounting Firm was not aware of the need for an Election Statement. The Year 1 Return was filed on or about Date9.

Discovery of Missed Election

On or about Date10, Taxpayer's tax department reconciled the Accounting Firm analysis to the general ledger and, in consultation with its accounting department, received the Financial Advisor Fee Email. Taxpayer's tax department determined that the $g line item, which represented the Debt-Related Services Fee, was actually part of the Total Fee paid by Z to Financial Advisor that included both the $f Transaction Advisory Services Fee and the $g Debt-Related Services Fee.

Accounting Firm advised that Taxpayer request relief under Rev. Proc. 2016-1 and Treas. Reg. §§ 301.9100-1 and 301.9100-3 for the missing election statement. Accordingly, Taxpayer is seeking relief to make an election for Year 1 under Rev. Proc. 2011-29 with respect to the Transaction Advisory Services Fee incurred in connection with the services provided by Financial Advisor.

LAW AND ANALYSIS:

Section 263(a)(1) of the Internal Revenue Code and § 1.263(a)-2(a) of the Income Tax Regulations generally provide that no deduction shall be allowed for any amount paid out for property having a useful life substantially beyond the taxable year. In the case of an acquisition or reorganization of a business entity, costs that are incurred in the process of acquisition and that produce significant long-term benefits must be capitalized. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 89-90 (1992); Woodward v. Commissioner, 397 U.S. 572, 575-576 (1970).

Under § 1.263(a)-5, a taxpayer must capitalize an amount paid to facilitate a business acquisition or reorganization transaction described in § 1.263(a)-5(a). An amount is paid to facilitate a transaction described in § 1.263(a)-5(a) if the amount is paid in the process of investigating or otherwise pursuing the transaction. Whether an amount is paid in the process of investigating or otherwise pursuing the transaction is determined based on all of the facts and circumstances. See § 1.263(a)-5(b)(1).

Section 1.263(a)-5(f) provides that an amount that is contingent on the successful closing of a transaction described in § 1.263(a)-5(a) ("success-based fee") is presumed to facilitate the transaction, and thus must be capitalized. A taxpayer may rebut the presumption by maintaining sufficient documentation to establish that a portion of the fee is allocable to activities that do not facilitate the transaction, and thus may be deductible.

A taxpayer's method for determining the portion of a success-based fee that facilitates a transaction and the portion that does not facilitate the transaction is a method of accounting under § 446.

Because the treatment of success-based fees was a continuing subject of controversy between taxpayers and the Service, the Service published Rev. Proc. 2011-29. Rev. Proc. 2011-29 provides a safe harbor method of accounting for allocating success-based fees paid in business acquisitions or reorganizations described in § 1.263(a)-5(e)(3). In lieu of maintaining the documentation required by § 1.263(a)-5(f), this safe harbor permits electing taxpayers to treat 70 percent of the success-based fee as an amount that does not facilitate the transaction. The remaining portion of the fee must be capitalized as an amount that facilitates the transaction.

Section 4.01 of Rev. Proc. 2011-29 allows a taxpayer to make a safe harbor election with respect to success-based fees. Section 4.01 provides that the Service will not challenge a taxpayer's allocation of success-based fees between activities that facilitate a transaction described in § 1.263(a)-5(e)(3) and activities that do not facilitate the transaction if the taxpayer does three things. First, the taxpayer must treat 70 percent of the amount of the success-based fee as an amount that does not facilitate the transaction. Second, the taxpayer must capitalize the remaining amount of the success-based fee as an amount which does facilitate the transaction. Third, the taxpayer must attach a statement to its original federal income tax return for the taxable year the success-based fee is paid or incurred. This statement should: state that the taxpayer is electing the safe harbor; identify the transaction; and state the success-based fee amounts that are treated as not facilitating the transaction and the success-based fee amounts that are treated as facilitating the transaction.

Sections 301.9100-1 through 301.9100-3 provide the standards the Commissioner will use to determine whether to grant an extension of time to make an election. Section 301.9100-2 provides automatic extensions of time for making certain elections. Section 301.9100-3 provides extensions of time for making elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-1(c) provides that the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make certain regulatory elections. Section 301.9100-1(b) defines a "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin.

Section 301.9100-3(a) provides that requests for relief under § 301.9100-3 will be granted when the taxpayer provides evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting relief will not prejudice the interests of the Government.

Section 301.9100-3(c)(1) provides that the interests of the Government are prejudiced if granting relief would result in the taxpayer having a lower tax liability in the aggregate for all taxable years affected by the election than the taxpayer would have had if the election had been timely made. The interests of the Government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election had it been timely made, are closed by the period of limitations on assessment.

Section 301.9100-3(c)(2) provides special rules for accounting method regulatory elections. Section 301.9100-3(c)(2) provides that the interests of the Government are deemed prejudiced, except in unusual or compelling circumstances, if the accounting method regulatory election for which relief is requested is subject to the advance consent procedures for method changes, requires a § 481(a) adjustment, would permit a change from an impermissible method of accounting that is an issue under consideration by examination or any other setting, or provides a more favorable method of accounting if the election is made by a certain date or taxable year.

<u>CONCLUSION</u>:

Based upon our analysis of the facts and representations provided, Taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the Government. Therefore, the requirements of §§ 301.9100-1 and 301.9100-3 have been met.

Taxpayer is granted an extension of 60 days from the date of this ruling to file a Year 1 safe harbor election under Rev. Proc. 2011-29 with respect to the success-based Transaction Advisory Services Fee discussed herein.

The rulings contained in this letter are based on information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether Taxpayer properly included the correct costs as its success-based fees subject to the retroactive election, or whether Taxpayer's transaction is within the scope of Rev. Proc. 2011-29.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, a taxpayer filing its return electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of the letter ruling.

In accordance with the provisions of the power of attorney currently on file with this office, a copy of this letter is being sent to your authorized representatives. We are also sending a copy of this letter to the appropriate operating division director. Enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

BRIDGET TOMBUL
Chief, Branch 2
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure:

Copy for § 6110 purposes